PERKINS & CO

Let's get there

Latest Developments in Income and Estate Tax Planning

Roy Abramowitz, CPA, CFP
Shareholder

Amy Kutzkey, CPA
Tax Senior Manager

January 19, 2016

Protecting Americans from Tax Hikes (PATH) Act

Overview

- Permanent extenders
- Temporary extenders
- Incentives
  - Charitable giving
  - Growth, jobs, investment and innovation
  - Real estate
  - Other
- Program integrity

Permanent Extenders

Tax Relief for Families & Individuals

- Enhanced child tax credit
- Enhanced American opportunity credit
- Enhanced earned income credit
- Teacher’s above the line deduction for $250
- Mass transit exclusion
- State and local sales tax deduction

Charitable Giving Incentives

- Modification of rules on real property for conservation purposes
- Tax-free distributions from IRAs for charity
- Modification of contributions of food inventory
- Modification of tax treatment of payments to controlling exempt organizations
- Basis Adjustment to S Corp stock making contributions of property

Growth, Jobs, Investment &Innovation Incentives

- Modification of research credit
- 15 year straight line for qualified leaseholds
- Modification of employer wage credit for active duty military
- Increased Section 179 limits of certain real property
- Treatment of dividends of regulated investment companies

Growth, Jobs, Investment &Innovation Incentives (cont'd)

- 100% exclusion of gain on certain small business stock
- Reduction in S-Corp recognition period for built-in gains tax
- Subpart F exception for active financing income

Real Estate Investment Incentives

- Minimum low-income housing tax credit
- Military housing allowance exclusion
- RIC qualified investment entity under FIRPTA

Extensions Through 2019

Extensions through 2019

- New markets tax credit
- Work opportunity credit
- Modification of bonus depreciation
- Look-thru treatment of payments between related CFCs

Extensions Through 2016

Tax Relief for Families & Individuals

- Exclusion of up to $2M of COD income from principal residence
- Above the line deduction for tuition and fees
- Mortgage insurance premiums as qualified interest

Growth, Jobs, Investment & Innovation Incentives

- Indian employment tax credit
- Railroad track maintenance credit
- Mine rescue team training credit
- Qualified zone academy bonds
- Race horses as 3-year property
- Motorsports complexes as 7-year property
- Moratorium on medical device excise tax

Energy Production/Conservation Incentives

- Modification of nonbusiness energy credit
- Energy-efficient new homes credit
- Energy efficient commercial building deduction
- 2-wheeled plug in electric vehicle credit
- 2nd generation biofuel producer credit
- Biodiesel/renewable diesel incentives
- Alternative fuels excise tax credit

Program Integrity

Program Integrity

- Modification of filing dates on W-2s/1099s
- Safe harbor for de minimis errors on returns
- Expands definition of allowable distributions from Section 529 Plans
- Delays ACA excise tax on “Cadillac” health insurance plans for 2 years
- One year moratorium on the ACA health insurance provider fee
- Delays the 2.3% medical device excise tax
- Modifies/clarifies REIT rules

Program Integrity

And the biggest one of all…

- Increased funding of the IRS to:
  - Make measurable improvements in customer service
  - Improve the identification and prevention of tax refund fraud and identity theft

The Highway Bill

Income Tax vs. Estate Tax Planning

There's a new game in town – income tax vs. estate tax planning!

- The federal estate tax has all but disappeared: 99.8% will never file a federal estate tax return
- But is that true? e.g. Oregon, Washington, portability
- Build flexibility into planning documents
- Consider strategies to achieve basis step-up (e.g. substitution powers, disclaimers)

New Basis Consistency Rules

Recipient's basis of property received = Fair Market Value (FMV) reported by decedent

- Applies to all estate tax returns (706) filed after July 31, 2015
- New information reporting requirement for inherited property
- Executor has 30 days after filing 706 to notify IRS and all beneficiaries (Form 706 Value, Finally Determined Value, Statement Value)
- Failure to file penalties apply
- New rules do no apply to any beneficiary who inherits property that did not **increase** the estate tax due (e.g. marital deduction, Portability)
- All sorts of questions – lack of guidance
- Reporting requirement delayed until 2/29/16 or when IRS issues guidance, if sooner
- Draft Form 8971 released 12/18/15 to fulfill reporting requirement

New Due Dates

- New due dates for most returns—for taxable years starting after 12/31/15 (2016 returns):
  - Partnerships and S Corps: initial due date > 3/15; extension > 9/15
  - C Corporations: initial due date > 4/15; extension > 9/15
  - Trust returns: initial due date > 4/15; extension > 9/30
  - Fin Cen (foreign bank account) returns: initial due date > 4/15; extension > 10/15
  - Nonprofit returns (Form 990): automatic 6-month extension

Portability

Portability

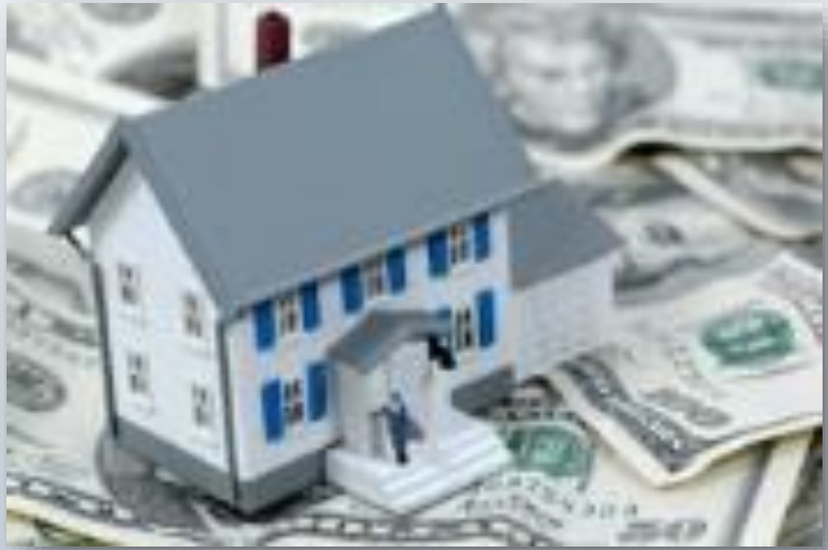
Law of the land since 2013 and here to stay!

› What is it?

  - Surviving spouse is entitled to use **Deceased Spouse's Unused Exclusion (DSUE)** *(last deceased spouse only)*
    - DSUE amount never changes
    - Election made on a timely filed estate tax return (706)
    - "9100 relief" may be available for missed elections
    - Surviving spouse must be a US citizen or resident alien
    - Applies to gift tax but not generation skipping tax
    - Statute of limitations on deceased spouse's 706 stays open until it has run on surviving spouse's 706

Portability: Basic Example

Couple has combined taxable estate of $10M—$4M in spouse A's name and $6M in spouse B's name. Spouse A dies in 2016 funding a WA bypass trust with $2,079,000 leaving the remainder to B. Executor makes portability election, what happens?



Portability: Basic Example (cont'd)

Spouse A's Basic Exclusion Amount in 2016	5,450,000
Less: Spouse A's WA bypass trust	(2,079,000)
Spouse A's DSUE amount	**3,371,000**

Spouse B's Basic Exclusion Amount in 2016	5,450,000	Indexed for inflation
Plus Spouse A's DSUE amount	3,371,000	Not indexed for inflation
Spouse B's adj. Basic Exclusion Amount	**8,821,000**	

Portability (cont'd)

- Tax considerations include:
  - Surviving spouse's life expectancy
  - Growth rate of assets
  - Balance between income tax vs. estate tax rates
  - Trust tax rates
  - Carry-over basis vs. step-up (both decedent & surviving spouse)
  - Inflation rate of basic exclusion amount
- Remember: once elected, the DSUE amount is fixed and is not indexed for inflation
- Important: don't let the tax tail wag the dog!

Portability (cont'd)

	Income Tax	Estate Tax	
Federal (including NIIT*)	23.8%	40%	
Oregon	10%	16%	
Washington	0%	19%	
California	13.3%	0%	
		Fed Taxable Estate	Fed Non-taxable Estate
Combined Federal and Oregon**	31.4%	49.6%	16%
Combined Federal and California **	33.9%	40%	0%
Combined Federal and Washington**	23.8%	51.4%	19%

*Net investment income tax

** Combined highest effective marginal estate and individual capital gains tax rates assuming not in AMT

Portability (cont'd)

- Planning strategies include:
  - Leave 100% to spouse
  - Leave 100% to bypass trust
  - Leave 100% to Qualified Terminable Interest Property (QTIP) trust
  - Leave 100% to spouse; spouse makes a large gift
  - Combination of multiple strategies

Portability (cont'd)

› Non-tax considerations
  - Probate avoidance
  - Creditor protection
  - Generation skipping planning
  - Children from a first marriage
  - Asset management
  - Disposition control

Improving (and/or Revisiting) Popular Estate Planning Strategies

Client "Wishlist"

1. Control
2. Use and Enjoyment
3. Flexible/Amendable
4. Creditor/Divorce Protection
5. Save Taxes
6. Avoid Complexity

Client “Wishlist”

So…

“Keep everything exactly as it is now, but get it out of my taxable estate.”

This has been referred to as the “Pipe Dream Trust”

Which we all know doesn’t quite work!

Common Misperceptions

- I have an FLP: My planning is done.
- Because of compressed brackets, trusts are income tax inefficient
- Because of increased exemption, trusts are only for very wealthy
- Portability is better, more tax efficient and simpler than Credit Shelter trusts

I have an FLP: My planning is done…

Issues with this setup?

- Donee’s distributive share of income must be proportionate to his/her capital interest

AND

- His/her CONTROL over the partnership must be consistent with his/her status as partner

OR

- All income from partnership will be taxed to donor as if entity doesn’t exist

I have an FLP: My planning is done…

Planning ideas:

- Review FLPs from viewpoint of next generation
- Does next generation want to be partners with their siblings?
- Most inheritors do not want:
  - Shared controls
  - Same/Shared investments
  - Same distribution patterns
  - Inefficient income tax planning
  - Same advisors
  - Additional costs/unnecessary complexities
  - Sibling scrutiny

ATRA of 2012 – Impact on FLPs

Planning idea:

› Should kids give/sell interests back?

- The kids probably have large exemption amounts remaining
- Step-up in basis makes assets more valuable to the kids
- Client can allocate inheritances so that sharing is avoided

Planning Opportunities

- Review all of your clients' FLPs
- Basis planning trusts
- Portability vs. Credit Shelter Trusts
- Monitoring existing trusts that presently have tax inefficiencies

Prospects for Tax Reform*

***As presented to the Oregon State Bar Taxation Section on December 29, 2015 by Mark Prater, Deputy Staff Director and Chief Tax Counsel, United States Senate Finance Committee**

Prospects for Tax Reform

- General consensus something must be done with respect to one or more of the following:
  - Individual-only reform
  - Business-only reform
  - International-only reform
  - Corporate integration
  - Comprehensive tax reform

Questions to be considered

- Should tax reform be revenue neutral, revenue positive or revenue negative?
- To what purposes would increased revenues be deployed?
- Is it viable for higher-income taxpayers to shoulder burden of future fiscal demands?
- What will effects of higher marginal rates be on individuals and small business owners?
- What will effect be on US-based companies with multi-national operations?

Questions to be considered (cont'd)

- Should tax reform be limited to income tax or include other taxes such as payroll, estate, gift and GST?
- How comprehensive should tax reform be?
- What would any transition plan look like, including repatriation tax on untaxed foreign-source income?

Questions?

Roy Abramowitz, CPA, CFP
Shareholder
503.221.7500
rabramowitz@perkinsaccounting.com

Amy Kutzkey, CPA
Tax Senior Manager
503.802.8623
akutzkey@perkinsaccounting.com